

## Message Text

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ACTION SS-14

INFO OCT-01 ISO-00 EUR-08 EB-03 SP-02 TRSE-00 NSC-05  
NSCE-00 FRB-01 CIAE-00 SSO-00 ONY-00 /034 W  
----- 027201 /42  
O 161234Z DEC 76  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC IMMEDIATE 8818

LIMITED OFFICIAL USE SECTION 01 OF 03 LONDON 20315

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E.O. 11652: N/A  
TAGS: EFIN, UK  
SUBJECT: SITUATION REPORT, DECEMBER 16

REF: (A) STATE 267168; (B) LONDON 20221

1. THE CHANCELLOR'S BUDGET CUTS -- IMF PACKAGE.  
CHANCELLOR'S PACKAGE MADE PUBLIC EXPENDITURE SAVINGS OF  
1 BILLION POUNDS IN FY 77/78 AND 1.5 BILLION POUNDS IN  
FY 78/79 WHICH, COUPLED WITH INCREASED TAXES, THE PRO-  
POSED SALE OF 500 MILLION WORTH OF BRITISH PETROLEUM  
SHARES' AND INTEREST SAVINGS, IS FORECAST TO REDUCE  
PUBLIC SECTOR BORROWING BY 2 BILLION POUNDS TO 8.7  
BILLION POUNDS IN FY 77/78. THE BORROWING REQUIREMENT  
IS ALSO ANTICIPATED TO BE AT ROUGHLY THAT LEVEL IN FY  
78/79. IF GROWTH ACCELERATES FURTHER REDUCTIONS WILL BE  
CONSIDERED IN FY 78/79. THE FOREIGN EXCHANGE AND GILT  
MARKETS WERE NOT INITIALLY IMPRESSED, STERLING FALLING  
ABOUT 2 CENTS BECAUSE OF FOREIGN EXCHANGE MARKET DIS-  
ILLUSIONMENT. MOST PRESS COMMENT IS CRITICAL NOTING ON  
THE ONE HAND THAT THE PACKAGE MAY NOT BE ENOUGH TO RE-  
STORE CONFIDENCE IN THE POUND AND ON THE OTHER THAT  
CURRENT EXPENDITURE HAS BEEN LARGELY SPARED WITH MOST  
OF THE CUTS COMING FROM CAPITAL SPENDING OR FINANCIAL  
TRANSFERS, AND THAT THESE WILL HAVE A GREATER IMPACT ON  
PRIVATE SECTOR ACTIVITY AND EMPLOYMENT THAN ON THE  
PUBLIC SECTOR. THE FT FOR EXAMPLE CALLED THE PACKAGE  
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"THE VERY LEAST THE IMF WOULD ACCEPT AS A CONDITION

FOR ALLOWING THE GOVERNMENT THE FIRST INSTALLMENT OF THE LOAN...". PRESS AND COMMENTATORS NOTE THAT ONLY \$1.15 BILLION OF THE \$3.9 BILLION WILL BE MADE AVAILABLE IMMEDIATELY AND THAT FURTHER DRAWDOWNS WILL BE SUBJECT TO IMF CONDITIONALITY, ALTHOUGH SOME PRESS ARTICLES TAKE THE LINE THAT THIS CLOSE IMF SUPERVISION WHICH SOME POLITICIANS MAY REGARD AS HUMILIATING IS THE STRONGEST REASON FOR BELIEVING THAT THE GOVERNMENT MAY YET GET ITS SUMS RIGHT. THE TORY FRONT BENCH GREETED THE HEALEY PROGRAM WITH QUALIFIED APPROVAL; THE CBI'S APPROVAL WAS LESS QUALIFIED.

LAST NIGHT (DEC 15) WHEN JACK JONES, THE TUC'S MOST POWERFUL TRADE UNION LEADER WAS ASKED BY A TELEVISION INTERVIEWER FOR HIS RESPONSE TO THE CHANCELLOR'S BUDGET CUTS, HE PERHAPS SUMMED UP THE PREVAILING VIEW OF THE MAJORITY OF THE TUC LEADERSHIP. JONES SAID: "WE HAVE NO ALTERNATIVE BUT TO CONSOLIDATE OUR POSITION AROUND THE LABOR GOVERNMENT AND FIGHT THIS CRISIS THROUGH". THE TUC ECONOMIC COMMITTEE MEETS THIS MORNING AND IT WILL UNDOUBTEDLY BE VERY CRITICAL ABOUT SOME OF THEM, PARTICULARLY THOSE WHICH WILL INCREASE UNEMPLOYMENT IN CONSTRUCTION AND THE PUBLIC SECTOR AND WILL INVOLVE CUTBACKS IN EDUCATION OR SOCIAL SERVICES. SOME UNION LEADERS SUCH AS ALLEN FISHER, HEAD OF THE PUBLIC EMPLOYEES, AND OTHER TRADE UNION CHIEFS IN THE PUBLIC/CIVIL SERVICE SECTOR HAVE BEEN EXTREMELY CRITICAL OF THE GOVERNMENT'S ECONOMIC POLICIES AND ARE EXPECTED TO EXPRESS THEIR VIEWS VERY SHARPLY IN TODAY'S TUC DISCUSSION. THERE IS NO DOUBT THAT THE MEASURES JUST ANNOUNCED, COUPLED WITH THE HIGH LEVELS OF EMPLOYMENT AND INFLATION, WILL PLACE INCREASING STRAINS ON THE RELATIONSHIP BETWEEN THE TRADE UNIONS AND THE GOVERNMENT. WHILE THIS WILL NOT MEAN REJECTION OF THE CURRENT WAGE RESTRAINT POLICY, IT WILL MAKE AGREEMENT ON A THIRD PHASE OF WAGE RESTRAINT MUCH MORE DIFFICULT DESPITE THE CHANCELLOR'S SUGGESTION IN HIS ADDRESS YESTERDAY THAT INCOME TAX CUTS IN THE SPRING BUDGET WILL BE IN PART CONDITIONED ON A THIRD YEAR OF RESTRAINT.

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SOME ATTENTION IS NOW BEING GIVEN TO THE US AND WEST GERMAN ASSISTANCE AND ITS RELATIONSHIP TO ANY FURTHER ACTION ON STERLING BALANCES OR A "SAFETY NET". MARTIN AND BELL, REPORTING FROM WASHINGTON IN THE FINANCIAL TIMES, NOTE THAT HALF THE U.S. CREDIT IS TO COME FROM THE TREASURY'S EXCHANGE STABILIZATION FUND AND THE OTHER HALF IN FED SWAPS, "BUT THE LENGTH OF TIME

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NSCE-00 FRB-01 CIAE-00 ONY-00 SSO-00 /034 W  
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O 161234Z DEC 76  
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LIMDIS

C O R R E C T E D C O P Y (TEXT)

FOR WHICH IT WILL BE MADE AVAILABLE APPEARS TO HAVE BEEN LEFT DELIBERATELY VALUE FOR THE MOMENT. THIS SUGGESTS THAT THE US INTENDS TO KEEP A CLOSE WATCH ON THE PROGRESS OF THE BRITISH ECONOMY IN THE MONTHS AHEAD. THE ABSENCE OF ANY STATEMENT ON THE STERLING BALANCES INDICATES THAT THE BRITISH LEADERSHIP STILL HAS SOME WAY TO GO IN FORMULATING ITS OWN ATTITUDES TO THE PROBLEM OF THEIR RESOLUTION. HOWEVER, FUND SOURCES BELIEVE THAT SOME STATEMENT ABOUT THE BALANCES MAY FOLLOW THE PARIS MEETING OF THE GROUP OF TEN NEXT WEEK, AND THE US REMAINS COMMITTED IN PRINCIPLE TO SOME TALKS ABOUT THE BALANCES IN DUE COURSE." THE TIMES DESCRIBES THE US AND GERMAN CREDITS AS A HOLDING OPERATION, AND REPORTS THAT HEALEY SAID THAT TALKS WITH THE U.S. TREASURY AND FEDERAL RESERVE HAVE REVEALED A GENERAL DESIRE ON THE PART OF THOSE CONCERNED TO ACHIEVE A SATISFACTORY ARRANGEMENT FOR THE STERLING BALANCES. "I BELIEVE IT WILL BE POSSIBLE TO REACH AN AGREEMENT BEFORE LONG." THE TIMES SAYS THE US \$500 MILLION IS BEING MADE AVAILABLE IN THE FORM OF A CONVENTIONAL THREE-MONTH ROLL-OVER "SWAP" AND WILL BE REPAID NOT LATER THAN SEPTEMBER 1977.

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FOR MORE DETAILS ON THE CHANCELLOR'S ANNOUNCEMENTS AND ANALYSIS THEREOF, SEE LONDON'S 20283 220251), 20292, 20293, AND 20294.

2. MEANWHILE, THOUGH THEIR ACTION WAS OVERSHADOWED BY THE CHANCELLORS BUDGET MESSAGE, BRITISH MINERS GAVE THEIR LEADERS AN OVERWHELMING VOTE OF AUTHORIZATION IN SUPPORT OF STRIKE ACTION, IF NECESSARY. TO ACHIEVE THE NATIONAL UNION OF MINERS' CLAIM FOR EARLY RETIREMENT. THERE IS A WIDE GAP BETWEEN THE POSITION OF THE NUM AND THE NATIONAL COAL BOARD, ALTHOUGH THERE IS SOME REASON TO BE HOPEFUL THAT A COMPROMISE CAN BE ACHIEVED (LONDON 20260). NONETHELESS, THE DISPUTE REPRESENTS ANOTHER WORRISOME PROBLEM FOR THIS GOVERNMENT, AND ITS SOLUTION -- EVEN IF IT IS A COMPROMISE MA-- COULD TRIGGER OFF SIMILAR CLAIMS FROM OTHER UNIONS FOR EARLY RETIREMENT.

3. IN ITS QUARTERLY BULLETIN, THE BANK OF ENGLAND CALLS FOR A FURTHER TWO YEAR PERIOD OF WAGE RESTRAINT BEYOND THE JULY 1977 EXPIRATION OF THE CURRENT POLICY. AMONG THE MAIN POINTS OF THE BULLETIN:

--DOMESTIC CREDIT EXPANSION SHOWED A THIRD QUARTER INCREASE OF 2.96 BILLION POUNDS -- AN ANNUAL RATE FAR IN EXCESS OF THE 5.0 BILLION TARGET ANNOUNCED BY THE CHANCELLOR.

--ONLY 2/5 OF BRITISH INFLATION DURING THE FIRST HALF OF 1976 IS ATTRIBUTABLE TO HIGHER LABOR COSTS COMPARED TO 2/3 IN 1975.

--THE NATIONAL DEBT ROSE BY 9.55 BILLION POUNDS IN FY 75, TWICE THE PREVIOUS RECORD ANNUAL INCREASE.

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--OIL EXPORTERS CONTINUED TO REDUCE THEIR STERLING HOLDINGS DURING THE 3RD QUARTER ALTHOUGH AT A SLOWER RATE.

THE IDEA OF A WAGE AGREEMENT OF TWO YEAR'S DURATION IS LIKELY TO BE RESISTED STRONGLY BY THE TRADE

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FM AMEMBASSY LONDON  
TO SECSTATE WASHDC IMMEDIATE 8820

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LIMDIS  
UNION MOVEMENT.

24. FOREIGN EXCHANGE AND FINANCE. THE FINANCIAL MARKETS ON WEDNESDAY WERE SIM UNTIL THE CHANCELLORS PRESENTATION WAS COMPLETED. AT WHICH TIME PICES SELL SHARPLY.

STERLING ON WEDNESDAY MORNING HAD RECOVERED FROM ITS 2\$1.6760 TUESDAY CLOSING AND STOOD AT \$1#6858 AT 3:00. AFTER THE PRESENTATION WAS OVER, THE POU E HTPEE STEADILY DOWNWARD TO A LOW OF \$1.6625 SHORTLY BEFORE CLOSING. THE FINANCIAL TIMES REPORTS THAT BANU OF ENGLAND SUPPORT MAY HAVE BEEN RESPONSIBLE FOR LIFTING STERLING TO ITS 31#6680 CLOSE. TRADING IN NEW YORK AND THE FAR EAST CONFIRMED THE DAY'S LOSS. THE POUND OPENED TODAY AT \$1.6630.

THE GILT MARKET ON WEDNESDAY RECOVERED THE TS ITS TUESDAY LOSSES AS LONG AND MEEIUM MATURITIES I CREASEE BY 1/8# THE MAKET CLOSEE AT 3:30 THEREBY AVOIDING IMMEDIATE ADVERSEMARKET REACTION TO THE HI IWAQZUDGET, BUT MARKET PARTICIPANTS WHO FOR SOME TIME HAVE STRESSED THE NEED TO EXAMINE THE MAKEUP RATHER THAN THE AGGREGATE SIZE OF THE PACKAGE, EXPRESSED THEIR DISAPPOINTMENT WITH THE MEASURES.

THE EQUITIES MARKET WAS EXPERIENCING A GENTLE FALL UNTIL THE PACUAGE WAS AN OUNCED AT WHICH TIME MANY PRICES BOKE DOWNWARDS. THE FINANCIAL TIMES INDEX OF 30 ORDINARY INDUSTRIALSHAD FALLEN 2.4 POINTS BY 3:00 P.M. BUT AN ADDITIONAL 8.1 POINTS BY CLOSING TO REACH  
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313.8.

ARMSTRONG

NOTE BY OC/T: SECTION 03 OF 03 LONDON 20315; MESSAGE AS RECEIVED.  
CORRECTED COPY TO FOLLOW.

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## Message Attributes

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**Copy:** SINGLE  
**Draft Date:** 16 DEC 1976  
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**Decaption Note:** 25 YEAR REVIEW  
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